UNITED NATIONS
ECONOMIC AND SOCIAL COUNCIL

Distr.: GENERAL

E/ECA/CM.16/7
6 MARCH 1990

Original: ENGLISH

ECONOMIC COMMISSION FOR AFRICA

Eleventh meeting of the Technical Preparatory Committee of the Whole

Tripoli, Libyan Arab Jamahiriya
5-12 May 1990

ECONOMIC COMMISSION FOR AFRICA

Twenty-fifth session of the Commission/ sixteenth meeting of the Conference of Ministers

Tripoli, Libyan Arab Jamahiriya
15-19 May 1990

LG/NAIROBI

PROGRESS REPORT ON THE FOLLOW-UP ON AAF-SAP

(as of end February 1990)

INTRODUCTION

1. In resolution 676 (XXIV), which adopted the African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation (AAF-SAP), the ECA Conference of Ministers specifically requested for a number of important follow-up actions. These included:

(a) Submission of AAF-SAP to the Working Group of African Governors of the International Monetary Fund and the World Bank for inclusion in the memoranda to the Managing Director of the IMF and the President of the World Bank as well as the Joint Statement to the annual meeting;

(b) To undertake close consultations on AAF-SAP at management level with multilateral development and finance institutions;

(c) To undertake close consultations at technical levels, again, with the multilateral and finance institutions;

(d) Presentation of AAF-SAP to the 1989 second regular session of the Economic and Social Council (ECOSOC);

(e) To have AAF-SAP included in the agenda of the forty-fourth session and to have it circulated as a General Assembly document;

(f) Submission of AAF-SAP to the meeting of the Development Committee of the World Bank and the IMF.

2. In addition to these specific requests for follow-up as contained in resolution 676 (XXIV), the joint meeting of African Ministers of Finance and Ministers responsible for Economic Planning and Development had expressed a general wish to have AAF-SAP submitted to the OAU summit of African Heads of State and Government in July 1989 and to all "relevant fora".[1]

3. Over and above the explicit requests by the African ministers on the follow-up of AAF-SAP, it was well understood that there were a lot of actions that had to be undertaken to ensure the full and effective operationalization of the African Alternative. Firstly, in view of the realization that AAF-SAP had to be built on a new partnership not only among African Governments themselves but also between them and their development partners, there was need to sensitize the world at large about the African Alternative through, inter alia, massive diffusion of the document and the holding of public discussions and seminars. Secondly, in line with the request of the Blantyre Statement on AAF-SAP, it was necessary to undertake in depth studies of some specific policy instruments with a view to finding out how such instruments can best be operationalized in individual African countries. Thirdly, it had been anticipated that subsequent to the adoption of AAF-SAP, action had to be urgently taken at the country and subregional levels to assist countries to operationalize AAF-SAP.

---

[1] See para. 6 of the Addis Ababa Joint Statement by African Ministers of Economic Planning and Development and Ministers of Finance dated 10 April 1989.

4. The present paper reports on all the actions that have been taken by the ECA secretariat and others in ensuring an effective follow-up and operationalization of AAF-SAP. It should, of course, be noted that the present paper covers only a limited period of only eight months between the adoption of AAF-SAP in April 1989 and the end of the year. However, as will become clear in the next sections, it is astonishing how much has taken place in so short a time. The momentum that followed the adoption of AAF-SAP has been kept in full gear. The challenge is to maintain this momentum at even higher levels and ensure the full operationalization of AAF SAP at all levels.

5. Before specific actions are reported on in the sections that follow, it should be noted that AAF-SAP has indeed generated a lot of interest within and outside Africa. One indicator of such interest has been the demand for the published version of AAF-SAP. When AAF-SAP was launched in London on 6 July 1989, ECA had printed a total of 18,000 copies of AAF-SAP (10,000 copies in English, 5,000 copies in French and 3,000 copies in Arabic). As of the writing of this paper, the secretariat had run out of the printed copies and a reprint was being urgently considered. A second indicator of the world wide interest in AAF-SAP has been the extensive press coverage that it has retreived and continues to receive. A booklet showing some of the press coverage has been compiled to highlight the points of view expressed on AAF-SAP worldwide.

PART I: SUBMISSION OF AAF SAP TO ALL RELEVANT FORA AND WORKSHOPS

6. The secretariat of the Economic Commission for Africa has not let any opportunity go by in terms of submitting AAF-SAP to different fora where its consideration had important implications for its future operationalization. Below, the different fora to which AAF-SAP was submitted and the results thereof are briefly discussed. It should be stressed that in all the fora outlined below the African member States were of crucial assistance both in the process of submitting the document and in terms of supporting and soliciting others to support it.

A. The OAU Summit of African Heads of State and Government

7. Subsequent to the adoption of AAF-SAP by the ECA Conference of Ministers, it was submitted to the OAU Permanent Steering Committee which was preparing for the 1989 Summit of African Heads of State and Government. From there it was considered by the Council of Ministers of the Organization of African Unity at its fiftieth ordinary session. The Council of Ministers adopted resolution CM/Res. 1222(L) for consideration by the summit.

8. During the summit of the African Heads of State and Government, many African leaders expressed their support for AAF-SAP as well as the wish to get it effectively implemented in their individual countries. The summit adopted resolution 1222(L) which is annexed to this report (annex I). As per this resolution AAF-SAP was adopted at the highest level in Africa.

B. The Conference of Heads of State or Government of Non-aligned Countries

9. On the initiative of African countries represented in the non-aligned group of countries, AAF-SAP was presented to the ninth Conference of Heads of State or Government of Non-aligned Countries in Belgrade, Yugoslavia, in September 1989. With an amazing show of solidarity, the non-aligned summit gave all its backing to AAF-SAP and adopted a specific resolution recommending that AAF-SAP "should constitute a basis for constructive dialogue between African countries and their development partners in the implementation and financing of country programmes". This was one of the very rare occasions when the non-aligned summit put all its weight behind a specific development document such as AAF-SAP. The resolution adopted by the non-aligned summit is attached to the present report as annex II.

C. The ACP-EEC Joint Assembly

10. The ministerial meeting of the ACP-EEC which met in Versailles, France from 25 to 29 September 1989, considered AAF-SAP. In its resolution (see annex III) on the European Community's policy of structural adjustment in the context of the fourth Lome Convention, the ACP-EEC joint assembly was unequivocal in calling "on the governments of the member States and the Council and the Commission to do their utmost to put an end to the prevailing structural adjustment policy under the Bretton Woods Agreement,..and to reshape them radically in the form of an adjustment with transformation policy ...." The resolution further spelled out a number of important criteria to be taken as a basis for action in negotiating with development partners. (see operative paragraph 2 of the resolution in annex III).

D. The United Nations Economic and Social Council (ECOSOC)

11. In accordance with the specific request of ECA Conference of Ministers resolution 676 (XXIV), AAF-SAP was submitted to the ECOSOC second regular session of 1989 under agenda item 4, namely regional co-operation. ECOSOC expressed its interest in AAF-SAP and accordingly adopted a resolution which, inter alia, called upon "the international community especially developed countries and multilateral institutions to consider request to provide support to the country programmes prepared by African countries". The ECOSOC resolution is annexed to the present report as annex IV.

E. The United Nations General Assembly

12. The real climax of the long journey of AAF-SAP in international fora was its adoption by the General Assembly by vote on 17 November 1989. At the conclusion of a special debate during the plenary session of the General Assembly, it was voted 137 votes to 1, to adopt resolution 44/42 (complete text of which is reproduced as annex V to the present report) endorsing AAF-SAP and inviting "the international community, including the multilateral financial and

development institutions, to consider the framework as a basis for constructive dialogue and fruitful consultations.

i. The Working Group of African Governors of the International Monetary Fund and the World Bank and the Development Committee of the World Bank and the IMF

13. Again, as requested, AAF SAP was submitting for inclusion in the memoranda to the Managing Director of the IMF and the President of the World Bank. In the memorandum to the Managing Director of the IMF, the Working Party of the African Governors to the IMF and the World Bank devoted an entire section on the question of enhancing the adjustment process. This section is reproduced as annex VII of the present report. Similarly, in the memorandum to the President to the World Bank an entire section was devoted to the adjustment process and this is reproduced as annex VIII.

6. The International Conference on Popular Participation in the Recovery and Development Process in Africa, Arusha

14. Although AAF SAP was not directly discussed at the Arusha meeting on popular participation, it nevertheless formed a strong basis for the meeting as a whole. Indeed, in the Charter for Popular Participation that was unanimously adopted by government representatives and NGOs, it was reiterated that AAF SAP offered the best framework for an approach to sustainable development that has the full support of the people. The meeting also put on record its "disapproval of all economic programmes such as orthodox structural adjustment programmes which undermine the human condition and disregard the potential and role of popular participation in the process of development".[2]

H. Other International fora

15. It is also known that the African Alternative has been presented and/or debated at a number of other international fora either under the auspices of United Nations organizations or other sponsors in developing and developed countries. The most important of these include (a) the ILO sponsored Tripartite Symposium on Structural Adjustment and Employment in Africa, Nairobi, 10 to 12 October 1989, (b) the Abuja Conference on the Integration of Women in Development and (c) workshop by the Vienna Institute for Internal Development Co-operation and a seminar at Carlton University (Canada).

16. In the ILO symposium AAF-SAP was considered by the three parties at the meeting, namely 17 African Governments, 6 employer representatives and 6 labour union representatives along with international observers, that included the IMF, World Bank, OAU, ADB, ECA, United Nations specialized agencies, the Organization of African Trade Union Unity (OATUU), the International Confederation of Free Trade Unions (ICFTU) and the International Organization of Employers. On AAF-

---

[2] See paragraph 6 of the Charter for Popular Participation in Development and Transformation (see p. 11).

SAP the Symposium called for the adoption of AAF-SAP in individual African countries.

17. In its declaration entitled Participatory Development: The Role of Women in Africa in the 1990s, the Abuja meeting categorically requested that "As governments develop structural adjustment policies and programmes especially when working on public investment programmes with institutions like the World Bank they should take advantage of the changed World Bank's approach to include estimates to cushion the impact of these policies on vulnerable groups such as women, children and families in the low-status income brackets". In addition to specific proposals to strengthen AAF-SAP as regards "gender" issues the declaration urged that "The strategies proposed in AAF-SAP should form the basis for national actions geared to alleviate the burdens on women".

PART II: CONSULTATIONS WITH FINANCIAL AND DEVELOPMENT AGENCIES, DONORS AND NGOS

A. Consultations with the World Bank

18. In accordance with ECA resolution 676 (XXIV) the ECA Executive Secretary made contacts with the management of both the IMF and the World Bank. In response to these contacts, the World Bank convened a meeting in Washington on 10 May 1989 of the heads and/or senior officials of the major organizations such as OAU, ECA, ADB, UNDP, UNICEF, IMF as well as the United Nations Secretariat to consider issues relevant to AAF-SAP at a policy-making level. The main result of this meeting was the building of a consensus on a number of areas. This constituted a major step in paving the way for a more pragmatic consideration of AAF-SAP especially by the World Bank. The full text of the joint statement issued at the end of the meeting is reproduced as annex 4 to the present report.

19. Technical consultations were also held in Washington from 30 November to 1 December 1989 between the technical staff of ECA and those of the World Bank. This meeting followed up on the general areas of agreement that had been reached at the policy level and further defined new ones. The meeting also endeavoured to narrow down the areas of disagreement between ECA and the World Bank. Broad agreement was reached on the major development objectives for African countries, the need to pursue adjustment in tandem with transformation, the need for flexibility in programme design, and the role and need for diversified exports. Outstanding issues on which consensus had yet to be reached included the role of markets versus administrative mechanisms in the allocation of credit and foreign exchange, the sustainability of liberalized foreign exchange systems and the appropriate pace of stabilization.

B. Consultations with the IMF

20. Subsequent to formal contacts and informal discussions between the ECA Executive Secretary and the Managing Director of the IMF, the IMF invited a technical team of ECA staff to the IMF to examine, in an analytical way and at a technical level, some of the specific policy approaches of AAF-SAP. The technical meeting took place in Washington on 27 and 28 November 1989.

21. The discussions focused on AAF-SAP and areas of consensus were defined. In addition, the discussions sought to narrow some of the differences that were perceived to exist regarding IMF approaches to stabilization and AAF-SAP proposed approach to adjustment with transformation. The meeting with the IMF reached a broad agreement on the seriousness of the economic and financial problems facing African countries, the need for strong and balanced reform programmes that would allow for sustained growth and transformation; Africa's development objectives notably the achievement of self-sustaining growth and development, the alleviation of poverty and the needed transformation of economic and social structures. The Fund indicated its concurrence with the need to incorporate sustained growth and income distribution issues in adjustment programmes. The Fund, however, expressed reservations on some AAF-SAP proposals particularly those which encouraged greater reliance on controls and a generally inward-looking policy stance involving in particular, policies like subsidies and price controls, selective credit, differential interest rates, multiple exchange rates, trade and payments arrangements as well as barter agreements to promote interregional trade and the limitation of debt-service payment ratios.

C. Consultations with donors

22. The interest generated by AAF-SAP has not been limited to international fora only. A number of donor countries expressed tremendous interest in AAF-SAP and in some cases the Executive Secretary of ECA has been able to hold consultations with officials of donor governments specifically on AAF-SAP. In the few months between the adoption of AAF-SAP in April 1989 and the end of the year, the Executive Secretary had held official consultations and/or briefings on AAF-SAP with high officials of the governments of Canada and the Netherlands. These consultations/briefings have proved to be very fruitful in terms of bringing about a greater understanding of the major concerns of AAF-SAP. In addition to these consultations, the ECA technical team that visited the IMF and the World Bank held consultations with congressional staff aides in Washington, 29 November 1989 involving staff from committees that deal with Senate Foreign Relations, House Foreign Affairs, House Banking and House and Senate Appropriations.

23. On 17 February 1990, the Executive Secretary was invited to address the Commission for Development and Co-operation of the European Parliament of the EEC on AAF-SAP. This meeting was of particular importance given the existing links of African countries with the EEC, especially within the context of the ACP-EEC Lome Convention.

D. Consultations with NGOs

24. In line with the call of AAF-SAP for a broad-based participation in development, the follow up activities have not only focused on government organs. Non-government organizations have also been fully appraised of AAF-SAP. In New York, an NGO meeting involving NGOs from Africa and those in developed countries was organized under the auspices of the Bahai to focus on AAF-SAP and the environment. The Executive Secretary of ECA addressed the meeting and raised

the awareness of all NGOs present on AAF-SAP. Another meeting of many Washington-based NGOs was extensively briefed about the concerns and issues that AAF-SAP raises and on its implementation. The meeting was held under the kind auspices of the office on Development Policy of the Church World Service/Lutheran World Relief. The NGOs expressed their appreciation of the concerns of AAF-SAP. During his visit to the Netherlands, the Executive Secretary also held meetings with the European Secretariat of the Forum of Debt and Development (FONDAD).

PART III OPERATIONALIZATION OF AAF-SAP

A. In-depth studies of selected policy instruments

25. As specifically requested for in the Blantyre Statement of Ministers of Finance, in-depth studies have been undertaken by the ECA secretariat. These studies have initially focused on three specific instruments that form part of the proposals of AAF-SAP namely (a) production subsidies, (b) multiple exchange rates systems, and (c) differential interest rate policy.

26. The main thrust of the studies is on both the theoretical and empirical basis for these policy instruments. At a theoretical level, the studies examine the basis for the use of these policy instruments and the theoretical assumptions behind such a basis. At the empirical level, the studies examine experiences of a number of countries that have used these policy instruments.[3] Overall, the studies on the policy instruments are intended to give to the African policy-makers the necessary guidelines on when and how to implement them in the framework of an AAF-SAP based country programme.

27. The initial drafts of the studies were discussed jointly by the African Planners and African economists at a Scientific Colloquium held in Addis Ababa from 16 to 19 January 1990. On the basis of the comments of the Colloquium, further work was undertaken to produce the final version of the studies to be presented to IEPCDW and the ECA Conference of Ministers in Tripoli, Libyan Arab Jamahiriya, in May 1990.

B. Formulation of model-types to analyze AAF-SAP policy instruments.

28. Although AAF-SAP outlined a generalized framework for application in the building of individual country models. It was evidently necessary to further define how the framework can be more elaborated. Thus work has been started in ECA to develop AAF SAP model-types that can be tailored to specific country situations in the analysis of the different policy instruments.

29. In accordance with the spirit of AAF-SAP, the model-types that are being developed do not constitute a sort of standardized model to be applied in all African countries irrespective of their peculiarities. Rather, the model-types are intended to serve as well-defined outlines of models along which country-

---

[3] The countries covered include those in Africa, Latin America, Asia and Europe.

specific models can be designed. Like the policy studies, the preliminary specifications of the model-types were presented to the meeting of African economists and African planners for an in-depth examination and suggestions for improvements. Among the recommendations made on the model types developed to operationalize AAF-SAP are the following:

(a) The small model types proposed should be expanded to include more explicative variables of inflation and to explicitly incorporate the aspects of capital flight and its impact on domestic production;

(b) The models should be sent to all countries for national modelling experts to study;

(c) A meeting of African specialists in modelling should be organized.

C. Operationalization of AAF-SAP at the Country level

30. It is obvious that only a short time has elapsed since the adoption of AAF-SAP in April 1989. However, even in this relatively short period, the ECA secretariat has endeavoured to respond to requests from member States for the operationalization of AAF-SAP at the country level. The first country to which the first AAF-SAP mission has been undertaken is Lesotho. The mission which was headed by the Executive Secretary of ECA undertook a series of high-level discussions with the leaders and officials of Lesotho and a number of policy issues were discussed. A model for Lesotho is expected to be developed with a follow-up mission in 1990. The ECA secretariat also supported the Uganda Economic Association which organized a national Workshop on Structural Adjustment in May 1989.

31. It, of course, goes without saying that the individual African countries have the largest role in operationalizing AAF-SAP, taking into account their unique objectives, priorities, requirements, problems and time perspective. As such, it is sincerely hoped that African countries will initiate the necessary actions to ensure that AAF-SAP is fully operational at the country level. Crucial among these actions are the following:

(a) Wide popularalization of AAF-SAP at the country level including its contextualization to the conditions of the country;

(b) Analysis of policy options that could be adopted for the recovery and transformation of national economies;

(c) Design and broad-based discussions of policy framework positions consistent with AAF-SAP;

(d) Design of actual programmes for negotiation and implementation.

D. Operationalization of AAF-SAP at the Subregional Levels

32. It will be recalled that AAF-SAP puts particular emphasis on the necessity for inter-country consultations in the designing and implementation of country programmes. It is in this context that ECA intends to vigorously promote the dimension of operationalizing AAF-SAP at the subregional level through, especially, subregional workshops and seminars at different levels - technical and policy-making.

33. Hitherto, no subregional workshop has yet been organized. However, the ECA secretariat has received a number of requests for the organization of such workshops. The Joint Conference of African Planners, Statisticians and Demographers held in Addis Ababa from 15 to 20 January 1990 also made a strong appeal for the holding of subregional seminars on AAF-SAP.

34. In an effort to respond to these requests, ECA approached UNDP with a project to fund the organization of these meetings. However, ECA has been informed by UNDP that, due to budgetary constraints, it was not able to fund the project. As such, even the seminars that had already been envisaged have had to be postponed. It might be necessary for the Conference of Ministers to make a special appeal to UNDP to fund the crucial subregional seminars on AAF-SAP.

35. Finally the ECA MULPOCs have also started the process of facilitating inter-country consultations. It is, indeed, hoped that at all meetings of the MULPOCs, there will be a thorough consideration of how the MULPOC mechanism can be effectively utilized for the inter-country aspects of programmes of adjustment with transformation in Africa.

Annex I

RESOLUTION ON THE AFRICAN ALTERNATIVE FRAMEWORK FOR STRUCTURAL ADJUSTMENT PROGRAMMES FOR SOCIO-ECONOMIC RECOVERY AND TRANSFORMATION (AAF-SAP)

The Council of Ministers of the Organization of African Unity, meeting in its fiftieth Ordinary Session in Addis Ababa, Ethiopia from 17 to 22 July 1989,

Reaffirming Africa's development objectives as contained in the Lagos Plan of Action and the Final Act of Lagos; Africa's Priority Programme for Economic Recovery, 1986-1990 (APPER) and the United Nations Programme of Action for African Economic Recovery and Development, 1986-1990 (UN-PAAERD),

Recalling the United Nations General Assembly resolution 43/27, urging African countries to "increase their efforts in the search for a viable conceptual and practical framework for economic structural adjustment programme in keeping with the long-term development objectives and strategies at the national, subregional and regional level",

Concerned with the unabated deterioration in the economic and social conditions in African countries in spite of the commendable efforts of African Governments to implement policy reforms and to undertake stabilization and structural adjustment programmes, often with the support of the International Monetary Fund (IMF) and the World Bank,

Convinced that African countries must continue to adjust their economies but at the same time ensure that any adjustment will bring about structural transformation and sustained growth and development,

Having considered the African Alternative Framework for Structural Adjustment Programmes for Socio-economic Recovery and Transformation (AAF-SAP) and ECA Conference of Ministers resolution 675 (XXIV) and Addis Ababa Joint Statement by African Ministers of Finance on the "African Alternative Framework for Structural Adjustment Programmes for Socio-economic Recovery and Transformation (AAF-SAP)":

1. COMMENDS the timely initiative of Africa's Ministers of Economic Development and Planning and Ministers of Finance for the preparation of the African Alternative Framework for Structural Adjustment Programmes for Socio-economic Recovery and Transformation (AAF-SAP);

2. ADOPTS the African Alternative Framework for Structural Adjustment Programmes for Socio-Economic Recovery and Transformation (AAF-SAP) as a pragmatic framework which will assist African countries, individually and collectively, in formulating country programmes that integrate adjustment with transformation and growth;

3. TAKES NOTE of the major points of consensus agreed upon at the meeting of 10 May 1989 in Washington, convened by the World Bank to discuss issues concerning SAPs in Africa, and in this context WELCOMES that meeting as constituting an important beginning of the dialogues on AAF-SAP;

4. APPEALS to the international community, particularly the multilateral development and finance institutions, to show full understanding for the African point of view concerning structural adjustment;

5. RECOMMENDS to the African Governments to use AAF-SAP as the framework for preparing their country programmes and for negotiating assistance from the donor community and to organize national and subregional seminars on the implementation of the AAF-SAP with the assistance of ECA, OAU and ADB;

6. REQUESTS the African Group of Ambassadors at the United Nations in New York to have placed on the Agenda of the forty-fourth session of the United Nations General Assembly, an item on the consideration of the AAF-SAP to enable the international community to consider the issue in detail.

Annex II

NINTH CONFERENCE OF HEADS OF STATE OR GOVERNMENT OF NON-ALIGNED COUNTRIES

CRITICAL ECONOMIC SITUATION IN AFRICA

The Heads of State or Government:

- Expressed their serious concern at the continued deterioration of the economic and social situation in most African countries, which has undermined their capacity to ensure for their people the basic necessities of life. As a region, Africa is most exposed to both natural calamities and the adverse international economic environment which continues to militate against the economies of these countries, particularly the sub-Saharan African countries.

Noted that, as the region with the highest dependence on commodity exports, Africa has suffered tremendous losses from both reduced demand and the sharp decline in prices. Between 1980 and 1986, non-oil commodity prices fell in real terms by 30 per cent; in 1987 they fell by another 10 per cent and continue to fall. Africa's external debt increased by over 70 per cent from 128.7 billion dollars in 1982 to 219.6 billion dollars at the end of 1987 and currently stands at over 230 billion dollars. The debt service to export ratio has exceeded the critical level of 25 per cent and in the case of some African countries is over 100 per cent. This heavy debt burden, coupled with heavy losses in export earnings and increased import costs, has resulted in an unprecedented net outflow of resources from Africa. The adverse terms of trade and the inadequate flow of financial resources have combined to further reduce the ability of African countries to sustain real growth and development. The serious structural reform of their economies which African countries are undertaking has not been complemented by adequate support of the international community.

- Drew the attention of the international community to Africa's Alternative Framework to Structural Adjustment Programmes, as drawn up by the Economic Commission for Africa and adopted by African Heads of State and Government at their July 1989 Summit, aimed at Africa's structural adjustment with transformation.

- Also drew the attention of the international community to the fact that three years after the adoption of the United Nations Programme of Action for African Recovery and Development (UN-PAARD) by the General Assembly, the international community has not yet given the appropriate support to its implementation despite vigorous and significant policy reforms pursued by African countries, which had exacted severe social and political costs.

The Heads of State of Government:

1. Urged the developed countries and the multilateral financial and development institutions not only to increase, in real terms, resource flows to Africa but also to improve the terms and conditions on which resources are disbursed;

2. Called upon the international community to accelerate the effective implementation of UN PAAERD by adopting policies conducive to accelerating growth and development in African countries;

3. Recommended that Africa's Alternative Framework to Structural Adjustment Programmes (AAF-SAP) should constitute a basis for constructive dialogue between African countries and their development partners in the implementation and financing of country programmes;

4. Expressed satisfaction with the significant progress made by the Southern African Development Co-ordination Conference (SADCC) in implementing the programmes of collective self-reliance and lessening the dependency on South Africa of the economies of its member countries. They urged the non-aligned countries to provide greater support to the SADCC programme and projects;

5. Took note, with satisfaction, of the results achieved by the AFRICA Fund, and called on all non-aligned and other countries to contribute to the Fund in order to accelerate the implementation of the objective of the programmes financed by it;

6. Commended all African regional and subregional economic groupings and organizations for the significant efforts they have made to promote the collective self-reliance of African countries.

Annex III

RESOLUTION [1]

ON THE EUROPEAN COMMUNITY'S POLICY OF STRUCTURAL ADJUSTMENT IN THE CONTEXT OF THE FOURTH CONVENTION OF LOME

The ACP-EEC Joint Assembly

meeting in Versailles from 25 to 29 September 1989,

A. having regard to the annual report of the International Monetary Fund (IMF) published on 19 September, in which, for 1988, a 9% growth in world trade is calculated, although in the case of the least-developed countries, it must be noted that they are confronted with very serious structural problems characterized by:

- very high inflation rates,
- increasing external trade deficits caused by a further decline in the terms of trade,
- increasing external indebtedness ($170 billion for the ACP States),
- decline in the standard of living, and
- vast social problems,

B. whereas, between 1980 and 1988, 33 African countries were forced to conclude standby agreements with the IMF and 15 countries received World Bank loans for structural adjustments,

C. having regard to the recent study by the United Nations Economic Commission for Africa (ECA) on an African alternative framework for structural adjustment programmes, with which the IMF and the World Bank will concern themselves at their annual meeting which is taking place this week in Washington,

D. whereas the United Nations Economic Commission for Africa comes to the conclusion that the current orthodox structural adjustment policy à la IMF and World Bank has proved itself to be totally inappropriate from both basic policy and empirical points of view for controlling the increasing crisis and has actually made it worse in many respects,

E. having regard to the largely catastrophic secondary effects of the IMF and World Bank policy - eg. regressive per capita income, reduced

---

[1] Adopted unanimously by the ACP-EEC Joint Assembly on 27 September 1989 in Versailles (France).

wages in real terms, increasing unemployment and underemployment, ever lower standards of social security services, and of education and training, increasing false nutrition and health problems, greater poverty and inequalities of income,

F. noting that the structural adjustment measures have largely failed, even when measured against the criteria established by IMF and World Bank officials: of the major indicators, only the relationship between the balance of payments and the gross national product shows any improvements after structural adjustments have been made; all other indicators such as the proportion of investment in the GNP, annual growth, the relationship between the budget deficit and the GNP, private consumption and the ratio of debt servicing to export revenue have deteriorated,

G. taking the view that, in view of this development and the increasing crisis, it is more urgent than ever to establish a new world economic order,

H. noting that structural adjustment policy has increasingly become a key instrument for the Member State governments and European Community institutions in their efforts to overcome the crisis facing the ACP States, in particular the problem of indebtedness, by means of a macro-economic policy of economic policy conditioning; this structural adjustment policy is due to be explicitly enshrined in the forthcoming Fourth Convention of Lomé,

I. having regard to the intention of the Commission and Council to promote structural adjustment measures not only from the economic but also from the political and social points of view,

J. having regard, further, in the agreement of the EEC negotiating partners in the Brazzaville negotiations for Lomé IV to specify more closely the plans for increased coordination and cooperation with the World Bank and the IMF and, as far as the EEC is concerned, to pursue its own specific adjustment policy,

K. whereas World Bank and IMF measures frequently contradict development policy measures taken by the European Community,

1. Calls on the governments of the Member States and Council and the Commission to do their utmost to put an end to the prevailing structural adjustment policy under the Bretton Woods Agreement - where Community Member States have a majority if they coordinate their policies - and other multilateral financial institutions and to reshape them radically in the form of an adjustment with transformation policy concentrating on a reduction of the extreme foreign dependence of the ACP States - and of the other developing

countries ; and on the encouragement of a self-determined development;

2. Calls on the parties negotiating Lomé IV, when enshrining structural adjustment policy in the fourth convention of Lomé, to ensure that the following criteria are taken as the basis for their actions:

(a) under no circumstances must cooperation with the ACP States be made dependent on the introduction of a structural adjustment policy along the lines laid down by the IMF and the World Bank,

(b) the introduction of structural adjustment measures must not endanger instruments and measures established previously under the first three Conventions of Lomé,

(c) an exact definition must be laid down of what is meant by structural adjustment, i.e. not the social and political shocks caused by the disastrous consequences of the rigorous adjustment policy of the IMF and the World Bank but a policy which enables the ACP States to develop their own domestic market oriented approach,

(d) development strategies must be promoted which concentrate on:

- alleviating poverty and increasing the standard of living of the majority of the population,

- incentives for an independent and permanent process of growth and development,

- promotion of the economic integration of Africa, the Caribbean and the Pacific in the context of national and regional self reliance,

in this connection, support must be given to reorientation to national consumer patterns and indigenous production capacity (as proposed also in the ECA study on structural adjustment programmes);

3. Calls on the Commission and the Council of the European Communities to ensure that the EIB and the EMF waive the repayment by the ACP States of debt service and all outstanding debts;

4. Calls on the governments of the Member States of the European Community to cancel forthwith all demands on the ACP States and on all the other developing countries arising from

previous development aid loans and to provide future aid exclusively in the form of grants;

5. Calls on the Community to break with its previous concept of development and, jointly with the ACP States, in the course of the final negotiations for Lomé IV, to initiate further discussion on a fundamental change in world economic structures, unequal trade and protectionism;

6. Instructs its Co-Presidents to forward this motion for a resolution to the ACP-EEC Council of Ministers, the Council and Commission of the European Communities, the group of ACP States, every other developing country and the multinational financial institutions, especially the IMF and the World Bank.

Annex IV

ECONOMIC AND SOCIAL COUNCIL

REGIONAL CO-OPERATION

African Alternative Framework to Structural Adjustment Programmes for Socio-economic Recovery and Transformation

The Economic and Social Council,

Recalling General Assembly resolution 43/27 of 18 November 1988, in particular paragraph 35 (c) of the annex, in which the Assembly recommended that African countries increase their efforts in the search for a viable conceptual and practical framework for economic structural adjustment programmes in keeping with long-term development objectives and strategies at the national, subregional and regional levels,

Convinced of the urgent need for African economies to bring about structural transformation and sustained growth and development,

1. Takes note with interest of the African Alternative Framework for Structural Adjustment Programmes for Socio-economic Recovery and Transformation,[1] adopted by the Conference of Ministers of the Economic Commission for Africa in resolution 676 (XXIV) of 7 April 1989; [2] and the joint statement on Africa's long-term development;

2. Requests the General Assembly to consider taking action on the Framework as appropriate;

3. Calls upon the international community, especially developed countries and multilateral institutions to consider requests to provide support to the country programmes prepared by African countries.

---

[1] Copies of document E/ECA/CM.16/6/Rev.3 will be available in the languages of submission. The text will be circulated subsequently as document A/44/[illegible].

[2] See Official Records of the Economic and Social Council, 1989, Supplement No. 16 (E/1989/35), chap. IV.

Annex V

44/24. AFRICAN ALTERNATIVE FRAMEWORK TO STRUCTURAL ADJUSTMENT PROGRAMMES FOR SOCIO-ECONOMIC RECOVERY AND TRANSFORMATION

Date: 17 November 1989

The General Assembly,

Recalling its resolution S-13/2 of 1 June 1986, the annex to which contains the United Nations Programme of Action for African Economic Recovery and Development, 1986-1990,

Recalling also its resolution 43/27 of 18 November 1988 and, in particular, paragraph 35 (c) of the annex to that resolution, in which African countries were urged to increase their efforts in the search for a viable conceptual and practical framework for economic structural adjustment programmes in keeping with the long-term development objectives and strategies at the national, subregional and regional levels,

Taking note of the resolution on the critical economic situation in Africa adopted at the Ninth Conference of Heads of State or Government of the Movement of Non-Aligned Countries, held at Belgrade from 4 to 7 September 1989, [1] as well as paragraph 12 of section II of the Caracas Declaration of the Ministers for Foreign Affairs of the Group of 77, [2] adopted at the special ministerial meeting of the Group, held at Caracas from 21 to 23 June 1989,

Recalling resolution 1222 (L) [3] adopted by the Council of Ministers of the Organization of African Unity at its fiftieth ordinary session, held at Addis Ababa from 17 to 22 July 1989,

Recalling also Economic and Social Council resolution 1989/116 of 28 July 1989,

1. Takes note with interest of the African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation; [4]

---

[1] See A/44/551-S/20870, annex.

[2] A/44/361, annex.

[3] See A/44/600, annex I.

[4] A/44/315, annex.

2. Invites the international community, including the multilateral financial and development institutions, to consider the Framework as a basis for constructive dialogue and fruitful consultation.

Annex VI

A JOINT STATEMENT ON AFRICA'S LONG-TERM DEVELOPMENT

1. At the invitation of Mr. Barber B. Conable, President of the World Bank, the heads and senior officials of several major United Nations agencies committed to Africa's economic and social progress, as well as of the Organization for African Unity and the African Development Bank, met to discuss issues related to the region's economic recovery and long-term development. The meeting was held at World Bank headquarters in Washington, D.C. on May 10, 1989.

2. Following upon recent reports by the World Bank/UNDP and the Economic Commission for Africa (ECA), participants exchanged views on the serious development challenges facing Africa, and particularly on the structural adjustment programmes currently being implemented by many African Governments. While participants recognized that areas of disagreement remained, they emphasized their determination to work together and collaborate in the wide areas of consensus that exists. They agreed to strengthen mechanisms to achieve that result.

3. It was emphasized that policy reforms, whatever their form, must be relevant to specific country situations and must be designed, implemented and owned by the African countries themselves. It was further noted that the process of gaining public understanding and acceptance of the need for adjustment measures and economic transformation should be as broad-based as possible within the countries concerned.

4. Among the other major points of consensus agreed upon by the participants were the following:

(a) As the basic approach to adjustment issues has evolved, it has become clear that adjustment must be seen as part of a long term development approach and that it must take full account of the human dimension. Stronger efforts are required to assure that this consensus is translated into action. The future challenge is to assist Africa to transform the condition of its economies still threatened with stagnation and decline to sustainable growth with equity.

(b) While sustainable economic growth is imperative, it is only the means to the overarching objective of improving human welfare - for example, reducing infant mortality, increasing educational opportunity, improving health and ensuring food security. Economic adjustment must lead to the long term improvement in the quality of life of the African people. Particular attention should be given to protecting vulnerable groups during the adjustment process, including protection of core budget expenditure on social sector programmes. Special emphasis should be placed on employment opportunities.

(c) The shortage of technical skills and weak institutions are major impediments to Africa's growth and development. Priority should be given, therefore, to human resource development and national capacity building.

(d) The sustainable development and modernization of agriculture is central to Africa's future growth. New and appropriate agricultural technologies, and effective extension services, should be pursued.

(e) Conserving Africa's natural resource base and protecting the environment are urgent priorities. No time should be lost in designing and implementing environmental action plans.

(f) The process of increasing and improving regional economic co-operation and integration in African should be accelerated.

(g) Promotion of the private sector is of vital importance.

5. Participants agreed that while Africa's major efforts to achieve economic growth and recovery should be recognized, the continent continues to be confronted by major problems, including weak commodity prices and terms of trade. The donor community has responded with substantial flows that are being monitored in the context of the UN-PAAERD which was established following the 1986 special session of the United Nations General Assembly. Increased donor assistance is, however, required to support the efforts of the African Governments to expand their reform programmes, and promote sustained economic growth. Substantial debt relief measures are needed, since the external debt burden remains a severe constraint on African development.

6. The distinctive and complementary roles of the various agencies working to support Africa's development were recognized. It was agreed that further steps should be taken to strengthen collaboration and the channels of communication among the Bretton Woods institutions, United Nations agencies and the African regional organizations. It was agreed that this process of consultation should be continued. Participants expressed appreciation to UNDP for its offer to host the next meeting. In addition, participants agreed that it would be useful to further explore issues of structural adjustment, based on studies and major reports prepared by various agencies represented at this meeting.

7. Mr. Barber B. Conable was commended by participants for his constructive initiative in convening the meeting. The exchange of views was welcomed and widely viewed as being beneficial to Africa's long-term development prospects.

8. Among those attending the meeting were Professor Adebayo Adedeji, Under-Secretary General and Executive Secretary of the Economic Commission for Africa; Dr. Bertram Collins, Co-ordinator of the Steering Committee on the United Nations Programme of Action for African Recovery and Development; Mr. William Draper III, Administrator, Mr. Arthur Brown, Associate Administrator, and Mr. Pierre Claver Damiba, Assistant Administrator and Regional Bureau for Africa, UNDP; Mr. Richard Jolly, Deputy Director, UNICEF; Mr. Babacar N'Diaye, President, African Development Bank; Mr. Ide Oumarou, Secretary General, Organization of African Unity; Mr. O. I. Gondwe, Deputy Director, African Department, International

Monetary Fund; and Mr. David Wheley, representing the Director-General for Development and International Economic Cooperation. The World Bank was represented by Mr. Baxter M. Ignatius, President; Mr. Moeen F. Qureshi, Senior Vice President, Operations; Mr. Edward V. K. Jaycox, Vice President, Africa Region; and Mr. Stanley Fischer, Vice President and Chief Economist. The African Executive Directors to the World Bank, Messrs. Bonaventure, Tunna and Mwinyo also attended.

Annex VII

SECTION II THE MEMORANDUM TO THE MANAGING DIRECTOR OF THE IMF

Enhancing the adjustment strategy

Whilst there is little debate about the need for economic reform in Africa, serious questions remain about the dynamics of adjustment, including, in particular, the sequencing and the speed with which reform can be successfully implemented. In this context, it is our view that there is still room for a further adaptation of Fund-supported programmes to enhance their effectiveness as instruments for achieving long-term growth and development in Africa. There is need for a greater degree of transparency in program in addressing fundamental rigidities in African economies, such as the narrow productive base and dependency on few primary commodities .. major reasons why Africa benefited far less than other developing areas from the strength of demand in industrial countries .. low productivity, limited and deteriorating infrastructure and a weak administrative capacity. The widespread poverty, which is in part an outgrowth of these weaknesses, is also a major constraint to be tackled directly. These problems, along with others, have been at the center of the on-going discussion among ourselves and other economic policy makers in Africa in an effort to refocus attention on the development and modernization needs of Africa.

In this regard, we wish to draw your attention to the OAU Resolution on the African Alternative Framework to Structural Adjustment Programmes for Socio-economic Recovery and Transformation (AAF-SAP), adopted by the Assembly of Heads of State and Government in Addis Ababa in July 1989.

We must stress here that the particular content of an adjustment programme must reflect the consensus that emerges out of the exchange of views between the staff and the authorities. It is clear that such a consensus is crucial for gaining political support for the implementation of the programme: therefore, it is important that mission leaders be given greater flexibility to consider or present alternative adjustment scenarios without being too constrained by a particular approach agreed upon in the Fund prior to beginning the dialogue with the authorities.

We are of the view that adjustment policies cannot be driven solely by the imperative of achieving short- or medium-term balance of payments viability. In this regard we were heartened by the assertion in your letter of February 22, 1989, to our Chairman, that several programmes supported by ESAF have sought to increase real per capita income and contained explicit provisions for meeting the basic needs of the poor. However, we must also note that the actual performance of a number of these programmes has not measured up to expectations, leading to the conclusion that there is still much room for improvement. In particular, it has been observed in some of the Fund-supported structural adjustment programs that the issue of poverty seems to have been treated only indirectly.

Conceptually, we see the process of adjustment in Africa as a long-term phenomenon, consistent with the historical process of structural change. The outcome will depend on the quality and degree of policy and institutional reform and the period of time that the authorities are given to control and master various policy instruments. Moreover, the Fund staff must appreciate the importance of drawing on political and social considerations that are relevant to the country.

We suggest, therefore, that the strategy should emphasize such factors as education, technical training, health, communication and technological change, which are important determinants of productivity, the low level of which limits progress in our economies. Structural adjustment programs must deal explicitly with these factors because they form the basis for long term growth and development. In this connection, the emphasis in the orthodox adjustment programmes on shifting resources from the public to the private sector must be kept in perspective, given the important role that the former plays in Africa in developing infrastructure and promoting health and education. Fund-supported programmes must guard against undue emphasis on shock treatment to achieve fiscal consolidation in the short run because of the potential to undermine the overriding goal of long term economic growth.

Annex VIII

SECTION OF THE MEMORANDUM TO THE PRESIDENT OF THE WORLD BANK

The Adjustment Process

The first issue of major importance which we wish to address is the adjustment process. Our experience has confirmed that adjustment is indeed a difficult, prolonged and risky process. However, the fact that over half of African countries have embarked on structural adjustment is a clear indication that there is no viable alternative to this route.

Nevertheless, as you are aware, some controversial aspects of structural adjustment have been recognized in the Bank's review entitled "Report on Adjustment Lending". It is therefore understandable that some aspects of adjustment have generated a debate within Africa as well as in the international community.

In this regard we would like to place on record our appreciation for the initiative you undertook in convening a meeting in Washington on May 10, 1989 to exchange views with, among others, leaders of African development and financial institutions who are equally involved in guiding and supporting the adjustment process. We note that this meeting has laid the foundation for improved dialogue and stronger collaboration between the Bank and these institutions, particularly the United Nations Economic Commission for Africa and the African Development Bank Group, for the greater benefit of our countries. We also wish to draw your attention to the OAU Resolution on the African Alternative Framework to Structural Adjustment Programmes for Socio-economic Recovery and Transformation (AAF-SAP), adopted by the Assembly of Heads of State and Government in Addis Ababa in July 1989.

Turning now to some specific issues on the reform and adjustment process, we have stressed that the design of programmes should be realistic and be conceived within a longer term time-frame in order to elicit the required supply response. We have also stressed that in view of the fundamental and long-term structural constraints under which programmes are implemented, the design of programmes should be flexible and implementation adapted to evolving conditions. This will require, as called for in the AAF-SAP and elsewhere, acceptance of both the short- and medium term objectives of structural adjustment and the objectives of long-term development and transformation, as both processes are interrelated and should be simultaneously pursued, particularly in view of the challenge of alleviating widespread poverty in the African continent.

There is greater recognition that better ways and means need to be found for dealing with the social costs of adjustment. Given the heavy transitional costs and other costs of adjustment programmes, particularly for vulnerable groups, we believe that a more systematic approach should be adopted. It follows that the integration of compensatory measures for those most affected by adjustment, together with greater focus on poverty reduction and employment

generation, as well as food security, in the design process, should now become mandatory. Accordingly, these programmes should not only be sensitive to the social costs of adjustment, but to the human dimension in general. We would encourage the Bank to expedite the implementation and coverage of the Social Dimensions of Adjustment Project which is meant to meet these concerns.

There is also the need to simultaneously increase the institutional capacity of our countries to design, implement and monitor adjustment programmes. This is all the more necessary given the recognition that adjustment programmes are most likely to succeed if they are "owned" by and enjoy the full support of the government and the public of the country concerned. To further develop and strengthen this capacity therefore, we urge the Bank to assist African countries to upgrade their economic management institutions and management training establishments through direct programmes as well as through the work of the Economic Development Institute.

It is also clear that given the complex nature of the adjustment process itself, and since these operations, by their very nature, tax the implementation capacities of participating countries to the full, there is an urgent need to limit conditionality to the minimum necessary as well as to ensure that the pace and sequencing of reform measures is done in a manageable and realistic manner. Again, in your reply to us last year, you concurred with this observation which was also confirmed in the Bank's recent evaluation of ten years of adjustment lending. We hope to see this lesson on experience reflected and confirmed in Bank practice. As is well known, this issue calls for sensitivity by the staff to the particular circumstances of a given country especially with regard to the pace of implementation. It is our view that there have, in fact, been times when this understanding has not been fully reflected in the dialogue with member countries. This needs to change if, as has been conceded, sustainability of the adjustment process is dependent on the authorities' conviction about its realism. We know you share our concern and look forward to an improved quality of dialogue with our countries on all these issues.

The goal of adjustment with growth cannot be achieved unless policy-based programmes are complemented by specific investments which address our basic developmental challenges. Indeed, in your reply to our memorandum of last year, you agreed that it was desirable for the Bank not to neglect the growing need for specific investment projects in our countries. Human resources development, rehabilitation and investment in infrastructure, food security, and regional integration, should all benefit from such investments given the Bank's role as a development institution. We therefore look forward to the active implementation of investments in these areas in our countries.

While we accept that it may be necessary for the Bank and the IMF to consult on their assistance strategies to member countries, these institutions are independent and have different mandates. It is our expectation therefore that the recent agreement between the managements of the Bank and the Fund on closer collaboration will not result in prejudicing the development concerns of

the Bank or lead to cross conditionality, especially with regard to structural adjustment lending. We also expect to see the Bank continue to take the lead in assisting countries design and implement workable programmes. We hope to pursue this matter further with you in the follow-up discussions by our representatives.

1. Introduction

1. Exchange rate policy is now increasingly accepted as of central importance for long-term development strategy and for creating an enabling environment for growth and equity. The exclusive identification of exchange rate policies with stabilization or balance of payments management is giving way to its use as a major development policy. This is particularly critical in Africa for internal issues of development, galvanizing producing sectors, creating employment opportunities, modifying technologies, changing import-intensive consumption patterns, diversifying exports and promoting African self-reliance and integration. There is no alternative instrument of economic policy that has a comparably pervasive effect on all other economic decisions.

2. Hence orthodox Structural Adjustment Programmes (SAPs) or Economic Recovery Programmes (ERPs) embody an active exchange rate policy as a major component of their policy options. But exchange rate policy is typically addressed to the elimination of balance of payments deficits and to generalized export promotion. It embraces three basic elements, namely, massive and persistent currency devaluation, floating exchange rate and foreign exchange auction in some African countries. These measures are based on the operation of free market forces and the assumption of perfect competition with free mobility of resources.

3. But unfortunately, these exchange rate policies have not succeeded in achieving balance of payments viability and helping to reverse the African crisis. The resulting widespread dissatisfaction and frustration with the orthodox adjustment programmes and their policy instruments has prompted the elaboration of alternative policy instruments for managing Africa's recovery and transformation. In the African Alternative Framework to Structural Adjustment Programmes for Economic Recovery and Transformation(AAF-SAP), one of these recommended policy instruments is the multiple exchange rate system (MERS). As stated in AAF-SAP, this involves "utilizing the existence of de facto multiple exchange rate systems in a rationalized manner and/or creating and streamlining such a system for purposes of resource transfers, resource mobilization and reversal of capital flight and ensuring availability of essential imports". This should also include the "allocation of an increasing share of foreign exchange for imports of vital inputs for agriculture and manufacturing sectors".

4. Conversely, AAF-SAP indicates some exchange rate policies to avoid because they are inconsistent with African recovery and

---

[1] See AFR-SAP, p.40, Table 5.2 item A.2 and p. 39 item A.3.

[2] Ibid, pp. 37-8, Table 5.1.

transformation. These are generalized devaluation through open foreign exchange markets, currency auctions and large and frequent currency devaluations as well as "excessive dependence on market forces for getting the "prices right" in structurally distorted and imperfect market situations".

5. The attempt to use exchange rate policy in Africa to achieve parity with, or to eliminate, the parallel foreign exchange market is 'chasing the tail' or running after a shadow. This is because the operations of the parallel exchange market are governed by complex socio-economic factors, many of which do not respond to price signals. Such factors include the extreme scarcity of foreign exchange relative to its almost infinite demand; desire to avoid tax by not purchasing foreign exchange legally in order not to reveal income level; need to hide the recondite sources of some of the earnings used in parallel foreign exchange transactions; fear of armed robbers in open financial transactions, etc. For these reasons, it is not true that the parallel market exchange rate measures the true marginal cost of foreign exchange which its official price must capture.

6. It is for these reasons that "the issue of the importance of exchange rate policy and the form it should take is no longer an ideological matter. It has been reduced to a pragmatic matter of what will work most effectively in given countries and circumstances".

7. The theoretical and empirical grounds for these positions on foreign exchange policy in the African context are discussed below together with the feasibility of MERS and the modality for its practical application in African countries.

II. Unified Exchange Rate Regimes and Generalized Devaluation

8. The attractiveness of the multiple exchange rate system (MERS) derives partly from the nature and disadvantages of unified exchange rate regimes and generalized devaluation. The unified exchange rate regimes are the floating, free or flexible and the fixed or crawling peg exchange rate systems.

9. Floating exchange rate system - Though the floating exchange rate system may be a single or multiple system, it is commonly used as a unified system. In some African countries, this floating system is operated through foreign exchange auction on weekly, daily or other basis. Under a flexible exchange rate regime, free market forces of supply and demand determine the level of exchange rate. The main advantage of the system is that its open market determination insulates the domestic economy from changes in external reserves, so that loss of reserves does not necessitate domestic deflationary pressures. The depreciation and appreciation of the flexible exchange rate are the means of equilibrating the balance of payments.

10. This, however, implies a preference for speculators rather than government or the Central Bank to regulate the external

balance. The other disadvantages of the flexible exchange rate system are that it raises the cost of foreign exchange; its depreciation increases the local currency cost of imports and domestic production; and as the inflationary pressure results on the exchange rate, any inelastic demand for primary exports means that some of the advantages of the floating exchange rate system are lost. Moreover, a free exchange rate may require a larger fiscal outlay, and its operation tends to shift inputs to import-competing and export industries, regardless of domestic costs and priority requirements such as food. It is because of these disadvantages that developing countries that operate the floating exchange rate system tend to experience severe economic difficulties and abandon it. Thus Brazil's last exchange liberalization during 1965/79 was stopped because it led to very low rate of economic growth, and Uruguay's free exchange rate practices from 1961 and 1982 with the new peso were abandoned because of their inflationary effects. In Egypt, exchange liberalization during 1973/81 led to 75 per cent depreciation of the exchange rate. Zaire's longest experiment with the flexible rate system in sub-Saharan Africa from around September 1983 contributed much to severe balance of payments pressure and other economic problems that led to devaluation in 1986. The use of foreign exchange auction to achieve currency float also tends to divert scarce foreign exchange to speculative activities and excessive imports while facilitating capital flight.

Fixed exchange rate system

11. The fixed or crawling peg exchange rate system may also be single or multiple. It is commonly used as a single system and has the special advantage of ensuring stable currency values which encourage trade flow and growth, like the par value system under the gold exchange standard. Balance of payments deficits are corrected through the use of trade controls and external borrowing.

12. The major disadvantage of the fixed exchange rate system, however, is that it forces the domestic economy to adjust to the requirements of the balance of payments. So when there is a balance of payments deficit, controls have to be imposed that may hurt foreign trade and investment, thus generating deflationary pressure in the economy. Fixed exchange rates also tend to be over-valued and this retards exports and encourages excessive imports. This over-valuation of the exchange rate and protection of the domestic market through trade controls are major reasons for economic stagnation and capital outflow due to falling reserves under the fixed exchange rate system. The over-valuation of the fixed exchange rate often calls for generalized devaluation with its negative effects.

13. On account of these disadvantages, countries that practise the fixed exchange rate system tend to use the crawling peg with devaluation, or change to a multiple rate system. Thus Chile had a crawling peg rate during 1970/82 with a foreign exchange

crisis in 1982, while Ghana's crawling peg from 1973 to 1982 was associated with a cumulative devaluation of 58 per cent before it adopted a multiple exchange rate system. Uganda's fixed exchange system during 1973-80, Zaire's crawling peg for 1976-83 and Somalia's current (1973-83) were all preceded by a dual exchange rate system in view of persistent balance of payments problems.

General considerations

12. Generalized and massive currency devaluation is such a common prescription in developing countries that it deserves separate treatment. Devaluation is an adjustment measure that is usually applied under any foreign exchange regime for the purpose of eliminating balance of payments disequilibrium. A country devalues by reducing the external parity of its national currency, by lowering the value of its currency in terms of foreign exchange. This involves lowering its export prices in foreign currency and raising the prices of its imports in local currency, so that its exports become relatively cheaper while its imports become more expensive. This is supposed to increase the foreign demand for exports and raise foreign receipts, while at the same time reducing domestic demand for imports, increasing foreign payments and thus improving the trade balance and the overall balance of payments position.

13. The main advantages of devaluation are that it can eliminate currency overvaluation and enhance the international competitiveness of traded goods, especially agricultural exports. This is by shifting resources to import-competing and export industries in order to match the induced switch in expenditures from tradeables to local goods and services. But these benefits of devaluation [illegible] in practice in African countries for several reasons. For one thing, the overvaluation of the currencies of developing countries often is the consequence of speculative activities. Then there is the extreme scarcity of foreign exchange in these countries whose demand then seems to be price-inelastic. Some developing countries also have serious constraints against response to price incentives provided by devaluation, which cannot itself supply and ensure the inflow of domestic production to respond to new opportunities in export and domestic markets after currency devaluation because of myriad technical and supply difficulties.

14. Consequently, the disadvantages and perverse effects of devaluation in African countries typically outweigh their alleged advantages. Generally, an uncontrollable inflation is one of these disruptive effects of devaluation. There is "growing concern that exchange rate devaluation, whatever form it has taken, has led Africa into a period of excessively high rates of inflation in the 1980s". For example, from given world prices of traded goods, the domestic prices of such goods are their world prices adjusted for changes in the domestic currency value of foreign exchange. Hence devaluation has the immediate effect

of causing or fuelling inflation by raising the relative prices of traded to non-traded goods.

17. Tables 1a and 1b depict the massive and persistent generalized devaluation in selected African countries together with the associated high rates of inflation. The massive devaluations in the 1980s are indicated through the sharp reductions in exchange rates for the sample countries, with the exception of the last six countries in the table that resisted devaluation (the last five countries are among francophone members of the CFA zone whose currency is tied to the French franc). The least amount of de facto devaluation over the eight-year period in the table is about 300 per cent for Sudan, while countries like Ghana, Zaire, Uganda and Somalia have over 900 per cent.

18. Table 1b shows the correlation between these massive devaluations and pernicious inflation. Thus the average annual rate of inflation in the eight countries that devalued massively ranges from a minimum of 20.8 per cent to a maximum of 113.9 per cent, whereas the last six countries in the table that did not devalue had fairly stable price levels with moderate rates of inflation that range from a minimum annual average of 4.3 per cent to a maximum of 9.7 per cent. Generalized devaluation thus emerges clearly from the two tables as the most important single source of inflationary pressure in African countries in the 1980s.

Table 1a
Selected levels of exchange rate, 1982/89

Country	1982	1986	1988	1989 1st quarter
Ghana (cedi, c)	2.75	90.01	229.89	251.72
Nigeria (Naira, N)	0.670	3.816	5.853	7.5873
Uganda (shilling, USh	1.06	14.00	165.00	200.00
Sierra Leone (Leone)	1.23	35.587	39.062	14.052
Somalia (Shilling, Sh)	15.2)	90.50	270.00	140.00
Sudan (Pound)	1.30	2.50	4.50	4.50
Zaire (Zaire, Z)	5.716	74.10	274.00	441.00
Zambia (Kwacha, K)	0.929	12.708	10.00	10.369
Ethiopia (Birr, br)	2.07	2.07	2.07	2.07
Senegal (CFA)	336.25	322.75	302.95	319.73
Cameroon (CFA	336.25	322.75	302.95	319.73
Cote d'Ivoire (CFAC	336.25	322.75	302.95	319.73
Congo (CFA)	336.25	322.75	302.95	319.73
Central African Republic (CFA)	336.25	322.75	302.95	319.73

Note: These are average market exchange rates (sel.
Source: IMF, International Financial Statistics, vol. XLII, no. 12, December 1989.

19. Besides its pernicious inflationary effect, the theoretical conditions for devaluation to improve the trade

balance are typically not satisfied in African countries. Thus the classical Marshall-Lerner elasticity condition that requires the sum of the export and import elasticities of demand to exceed unity is not satisfied because of the very strong demand for imported necessities and low foreign demand for exports. Thus with relatively inelastic demand for their exports and imports, when these countries devalue, the demand for their exports and imports vary little. When their export demand is not restricted due to foreign protectionism and synthetic substitution, the long gestation period for increasing export production makes their export supply relatively inelastic and unable to benefit from devaluation in the short to medium-term. Agricultural exports are particularly prone to this supply rigidity. Moreover, in countries whose main exports are subject to quota at externally given prices, and with essential imports like petrol, drugs, capital goods, raw materials, spare parts, etc. devaluation produces a negligible effect on the balance of payments.

20. Generalized devaluation also raises the domestic cost of production and thereby decreases the competitiveness of local goods and services. The rising cost of domestic inputs also leads to capacity under-utilization. The change in relative prices that is supposed to switch demand from foreign to local goods after devaluation is also inhibited in African countries because of entrenched technical structures that do not permit much substitution of domestic for foreign inputs.

21. The assumption that devaluation can change the relation between wages and prices also disregards distributional equity that is affected by complex socio-economic factors. This is in addition to the fact that devaluation reduces the real value of given nominal wages. For agricultural producers also, even where devaluation increases nominal producer prices in local currency, these are often gobbled up by the even higher rate of inflation unleashed by the change in the relative prices of tradeable to non-tradeable goods. Such increases in the domestic price level also reduce the real value of private sector liquidity unless it is offset by commensurate changes in the domestic money supply.

22. Thus overall, as the internal effects of generalized devaluation tend to shift resources to import - competing and export industries, this stifles the domestic production of non-tradeables. Hence on balance, devaluation leads to rising inflation, increased unemployment, capacity under-utilization, sharp increase in the cost of living, distorted income distribution, reduced rate of economic growth, the undermining of public sector investment and of development priorities.

Table [illegible]: [illegible]

Country	Classification	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Ghana	April 1981 (De facto) Oct. 1982 (Actual) (Post-1982)	100 90 80											
Nigeria	July 1985 (De facto) 1987-88 (De facto)	100 50											
Uganda	May 1986 Recovery Base	50 100											
Somalia	1977 1981 1982 1983 1984 1985	5 10 20 30 40 45											
Zaire	Sept. 1983	50											
Sudan	n.a.	n.a.											
Somalia	n.a.	n.a.											
Sierra Leone	n.a.	n.a.											
Ethiopia													
Senegal													
Cameroon	-												
Cote d'Ivoire													
Congo	-												
Central Af. Rep.	-												

Note: n.a. = not available
Source: ECA, 1985.

III. Basis for Multiple Exchange Rate System and its Validity for African Countries

23. Multiple currency practices are designed to obviate the disadvantages of the other exchange rate regimes and to promote the development process. Theoretically, the multiple exchange rate system (MERS) is based on the separability of international transactions into different markets or categories. Hence, in principle, an infinite set of multiple rates are applicable to different transactions.

24. For these reasons, we encounter MERS in four common contexts, namely, development policy, balance of payments analysis, mechanisms of protection and the analysis of the fiscal analysis of international transactions, such as export and import taxes and subsidies. Since the 1980s, however, multiple currency practices have arisen mainly in balance of payments analysis in connection with stabilization and adjustment programmes. In this context, multiple rates underscore the differences between monetary adjustment and developmental policy. These differences in turn emphasize two critical points.

25. One is that when the underlying causes of balance of payments deficits are real or structural as in African countries (and in the rest of the Third World), monetary adjustment through devaluation generalized as in orthodox adjustment programmes typically fails. This is because this type of medicine for monetary adjustment addresses only the surface manifestation of the problem and, like a band, provides only temporary relief from the crisis, which tends to recur or even deepen. The real adjustment required to eliminate the structural causes of balance of payments disequilibria cannot be addressed within this monetarist framework. The second point is that in most Third World countries, and particularly in African, MERS has been and continues to be used and advocated primarily in order to promote recovery and development. This is a much higher priority and larger preoccupation in Africa and other developing regions than monetary or balance of payments stabilization. Indeed, in these countries, persistent monetary or payments imbalances are typical reflections of the underlying economic syndrome of underdevelopment. In these circumstances, the conceptual restriction of MERS to monetary adjustment or the elimination of balance of payments is thus an untenable linear transfer of its function from the advanced countries to the developing regions. This depicts a gap in the literature on the treatment of these multiple rates in developing countries just as the rest of the largely static and competitive neoclassical trade theory is seriously flawed and unsatisfactory in dealing with the reality in the developing countries.

26. In these developing regions, trade and development policy are intrinsically linked, so that trade and exchange policies are integral components of development policy. Hence monetary and real adjustment are also organically linked such that persistent

external imbalance can be eliminated in the process of monetary adjustment only through simultaneous adjustment in the real economy. This requires resource re-allocation among sectors, for example, towards domestic import - substitution and selective export expansion. These are precisely some of the major objectives of the application of MERS in African and other developing countries.

Advantages and Possible Limitations of MERS

27. The advantages for MERS far outweigh the possible shortcomings. In particular, they combine the main advantages of the other exchange rate regimes and avoid their major disadvantages. Thus, these multiple rates are often adopted to avoid generalized and massive devaluation and its disruptive effects such as severe inflationary pressure. Hence any devaluation under the MERS is limited.

28. With unbearable external debt service obligations, African countries can drastically reduce their debt service payments in local currency. This is done by applying a favorable rate for debt servicing relative to other external transactions. Thus in Egypt during February 1988, its multiple exchange rate system allowed authorized banks to sell 10 per cent of their monthly foreign exchange receipts for external debt service. Zambia also used multiple rates to reduce the local currency cost of its external debt service.

29. In developing countries, MERS is also useful for promoting structural transformation in two main ways. One is through the diversification of domestic production structures which can take the forms of promoting import-substitution by granting protection to local industries, offering premium exchange rate that constitutes a subsidy to some activities and applying a penalty exchange rate to discourage others. For countries at early stages of industrialization, this is a very stimulating policy. Brazil used a MERS as a deliberate policy to stimulate national development in the post-war. Ecuador used it after 1922 to reverse its economic deterioration, and Egypt has been using it since 1981 to boost its industrialization and raise living standards. The other transformational use of MERS is for selective export promotion in strategic industries. When multiple rates have a free component, it gives the right incentives to export industries and encourages capital inflow that can be used to expand the export sector. This involves the application of a favorable exchange rate to such industries as a form of export subsidy or a kind of export rebate that reduces the production cost of such activities and raises their international competitiveness. Thus in the post-war era, Uruguay applied the most favorable rate of its multiple rate system for 'wool tops' in order to penetrate the international market for the product that had been dominated by European producers. After 1982, Ecuador also operated a MERS whose main objective was to re-establish the long-run competitiveness of the economy. Egypt

also used multiple rates to increase its manufactured exports during 1982/83 and 1983/84.

30. Import control is another major advantage of the use of MERS in many developing countries. In this context, the multiple rates are used as trade policy in the form of tariffs. A low exchange rate can thus be maintained for essential imports to keep their total cost low so that the depreciation of the domestic currency during adjustment does not affect the majority of the population with low income. A higher exchange rate is then applied to non-essential imports similar to a high tariff on them to reduce import demand. Such a MERS can also be used as an anti-dumping device against cheap imports that may ruin domestic infant industries or import substitutes. Argentina used such multiple rates with selective import taxes after 1987 to control imports, Paraguay had different effective exchange rates for different categories of international transactions for restricting imports after 1985, and Egypt did the same during 1980/86 when its current account deficit rose. Ghana used its parallel market rate for its special import licence scheme (SIL) from October 1985 to control imports, while Nigeria, Uganda and Zambia also used the dual exchange rate system to restrict imports.

31. The MERS also enjoys the advantage of promoting confidence in an economy and encouraging the inflow of workers' remittances. This is particularly the case where increased returns on holdings of local currency relative to foreign exchange are offered through changes in interest rates and the rate of inflation. This is the case of the use of differential interest rate policy (DIRP) to supplement a MERS. Egypt has used multiple rates very successfully in this way to attract huge workers' remittances from neighbouring oil producing countries. This was done in 1968 with an official rate of Le 0.34 to the US dollar and another rate of LE 0.58 per dollar, and again in 1981 and 1987. Other countries like Ghana used multiple rates to attract remittances and tourism, while Zaire used its own dual rates during 1983/84 to curb diamond smuggling.

32. The control of capital flight is another important advantage of MERS. When one of the multiple rates is relatively high, it discourages the repatriation of capital and encourages capital inflow. This is critical for African countries that have been suffering from massive export of capital, especially since the 1980s.

33. Finally, a MERS in the African context has the additional merit of being suited to the pervasive market imperfections in the region. This is so central to the validity of the competitive model that is used for designing exchange rate policy in African countries that it is treated separately below.

34. Like all economic policies, however, MERS has possible shortcomings. These are first, that under MERS, there may be fraudulent transactions across foreign exchange markets. This is

optimum. Nevertheless, policies towards equilibrium may still be valid in the long-run context. This is clearly a long-term objective for which efforts to halt deterioration should not be sacrificed. Hence in the present state of underdevelopment in African countries, the system should not be for equilibrium as such, but for the most efficient way of managing disequilibrium so as to afford to achieve the respective viabilities.

38. Two examples will illustrate these competitive equilibrium problems in the foreign exchange markets of the African context. One is that during the seasonal pilgrimages, the demand for foreign exchange rises sharply for speculative purchases, and falls thereafter, regardless of the legal exchange rate. The other is that since the collapse of the Ugandan airlines, the demand for foreign exchange has fallen drastically and reduced the domestic value of the dollar without reference to the conventional market forces of demand and supply of export and imports.

39. In all such situations of 'market failure' and persistent disequilibrium associated with structural underdevelopment, a managed MFRS is superior to the other exchange rate regimes discussed earlier. Last and current empirical applications of the MFRS in such diverse countries as Brazil, Argentina, Chile, Ecuador, Paraguay and Uruguay in Latin America as well as in African countries like Egypt, Ghana, Madagascar, Nigeria, Somalia, Uganda, Zambia, Zaire and apartheid South Africa have demonstrated the validity of the MFRS in African countries under imperfect markets. Thus most countries design fairly simple multiple exchange rate system to avoid complications and then enforce the right discipline and controls in order to ensure its effectiveness. In these ways they maintain effective checks against outflows for foreign exchange transactions, and also prevent their multiple currency rates from becoming permanent. In this pragmatic way, countries have been able to operate MFRS to suit their peculiar circumstances.

Situations that warrant the use of MFRS in Africa

40. Besides the advantages of MFRS, SAF-SAP identifies some major motivations that warrant the use of MFRS in the context of Africa. These are: (a) requirements of restructuring; (b) "encouragement of capital inflows, especially by nationals working abroad and discouragement of capital flight; (iii) improvement in balance of payments; (iv) satisfaction of critical needs." These situations reflect the requirements of development strategy with regard to both monetary adjustment (i.e. balance of payments adjustments) and real adjustment. Thus the encouragement of capital inflows and the restriction of outflows is designed to generate a net inflow, which is critical for increasing the levels of aggregate investment and production as well as improving the balance of payments. The MFRS are also

---

[1] SAF-SAP, pp.36-40, Para. 50.

useful for providing a low exchange rate for essential imports like drugs, spare parts, petrol, agricultural chemicals, etc. for meeting the critical needs of the population.

41. In addition, MERS has also been used and is useful in African countries for the protection of infant industries, export diversification through the promotion of specific exports and for the encouragement of industrial activity. Thus from the 1960s when the post-war boom petered out, multiple rates have been used extensively in developing countries as deliberate instruments for structural transformation. This is through the granting of implicit import and export subsidies to promote some basic industries with high growth elasticities in order to accelerate the development process. Correspondingly, the MERS is also useful for shutting out non-essential imports in order to conserve scarce foreign exchange for the import of critical capital goods, intermediate products and raw materials for the development process.

Types of MERS and their uses

42. The separability of international transactions that makes MERS feasible points to two typologies. These are by (a) commodities and financial assets or capital transactions and (b) different groups of commodities and services.

(a) MERS for different groups of traded commodities and financial assets

43. The different dual or range rates for commodities and financial assets are:

(1) asymmetric dual rates for goods and capital flows;
(2) different dual rates for capital flows and investment returns;
(3) different rates for the repatriation of investment and returns.

(b) MERS for different groups of traded commodities and services

44. The multiple rates for different groups of traded goods and services are:

(1) exchange spread or margin between buying and selling rates;
(2) penalty exchange rate for some exports;
(3) subsidy rate for some exports;
(4) penalty rate for some imports;
(5) subsidy rate for some imports.

Approaches to the use of MERS

45. These eight different MERS correspond to four common approaches to the use of multiple rates, namely, by

(1) economic priorities, e.g., essential imports like drugs, capital goods, etc., debt servicing, export promotion, basic industries, etc.
(2) dual exchange rates, e.g. official and non-official or commercial and financial exchange rates;
(3) different import and export categories with a different exchange rate applying to each group of commodities.
(4) exchange spread or margin between buying and selling exchange rates.

46. Out of all these different types and approaches to MERS, the commonest one that is used by most countries that practise multiple rates are the official and non-official or the commercial and financial exchange rates. These multiple rates have three attractive features. First, they are simple and avoid the cumbersome complexity of many rates that are difficult to apply and enforce across transactions. Second, they do not usually apply to the capital account except for debt servicing which is not part of normal capital flows. Third, these multiple rates can be so designed that some are fixed within a range as crawling pegs while others are managed flexibly, so that the multiple rates enjoy the attractive advantages of both fixed and flexible exchange rates, while avoiding their major disadvantages.

Feasibility and Implementation of MERS in Africa

47. The empirical feasibility of MERS for African countries derives from the lessons of experience accumulated from its past and current practical applications in various countries in Latin America and Africa. These empirical experiences underscore some basic similarities in underlying circumstances, practical design, implementation, requirements and monitoring procedures in different countries.

Lessons of Empirical Experience with MERS

48. Several countries in Latin America and Africa have applied multiple exchange rates at various times and their empirical experiences provide important lessons for the use of MERS for recovery and transformation in Africa. These countries include Argentina, Brazil, Chile, Ecuador and others in Latin America as well as Egypt, Ghana, Nigeria, Uganda, Zambia, Zaire and apartheid South Africa among others.

49. In Latin America, the MERS or its equivalent has been used widely from the 1950s and it is still being used especially since the crisis of the 1980s. But the complex multiplicity of exchange rates practised in Brazil and other Southern countries of the

region have been abolished. The major reasons for the adoption of multiple rates in Latin America were because the use of official parity rates were inadequate for restricting import demand, while devaluation was seen as fuelling inflation, raising import cost and giving undue benefits to exporters. The conscious promotion of development and export diversification have also been additional reasons. Hence when many of these countries dismantled their multiple rate system, they imposed export taxes or retained exchange control. The most common problems or failures of the MERS in these countries have been : (a) the inclusion of most imports under the preferential exchange rates and few luxury items under the higher rates, so that such multiple rates were inadequate for suppressing excessive imports, and (b) the tendency to make the multiple rates more complex due to the pressure of exporters and importers to introduce new rates.

50. In African countries, multiple rates have been and are still used mainly for dealing with balance of payment deficits and debt servicing. The standard context has been short-term stabilization or structural adjustment. Hence the African experience with the MERS has tended to be for mainly monetary adjustment and over relatively short periods. Consequently, African countries have not used multiple rates widely so far for real adjustment or deliberate development policy and for longer periods as in Latin America, hence the poor performance of their exchange rate policies so far. Moreover, whereas multiple currency practice in Latin American countries typically refers to two or more legal exchange rates, there is a tendency to define dual exchange rates for African countries as involving an official rate and an illegal parallel market rate or usage, that restricts the feasibility of the MERS in Africa.

51. Overall, the cases of successful application of multiple rates typically hinge on the satisfaction of some basic conditions. One of these is non-complex design especially where there are fixed and free rates, the provision of adequate time for real adjustment to occur is also essential when the multiple rates have developmental objectives. The use of complementary policies such as export incentives, exchange control and restrictions on imports is also critical. The avoidance of massive, frequent and generalized devaluations and other destabilising policies, the maintenance of effective discipline that includes foreign exchange allocation to priority uses and the eventual unification of multiple rates to a managed crawling peg exchange rate were also essential. Fiscal - monetary reforms with moderate budget deficits and deficit financing were also necessary.

52. Conversely, the cases of poor performance of MERS were those that involved the use of many complex rates, large deficit financing with high rates of inflation, frequent currency devaluation and official interference with the controls of the MERS. The multiple rates should also not become permanent sources of raising fiscal revenue. These are the negative practices that should be avoided in the application of the MERS which is,

therefore, inconsistent with many aspects of orthodox structural adjustment programmes such as import liberalization, large and frequent currency devaluation, high interest rates and generalized credit squeeze.

53. Countries in Special Situations - These lessons of experience with the use of MERS direct attention to African countries in two special situations. These are:

54. (a) Currency Union Countries - these are countries tied to major international currencies such as francophone countries in the CFA zone. Their national currency, the CFA, is tied to the French franc. This means that their use of MERS has to be arranged with the members of the currency union in order to ensure that changes in parity between the CFA and the French franc are acceptable to all concerned.

55. (b) Integrating countries - MERS poses no problems for economic integration that involves the removal of trade barriers, and for production integration to exploit economies of scale. Different kinds of multiple currency practices in some African countries are also compatible with financial integration. Thus if there is a payments or clearing arrangement among countries, their use of MERS will require them to use an agreed unit of account, e.g., a common traveller's cheque as in PTA countries or an external currency like the SDR. Exporters of each commodity receive in their local currency, the amount established by the corresponding exchange rate, and importers will pay for the unit of account, the rates which the authorities will set for transactions. The clearing will then be among central banks in units of account which may be converted or not into other currencies, according to the agreement of the integrating countries.

56. When their MERS includes free market exchange rates for some transactions like capital movements or tourism, these can be settled in two possible ways. One is to leave such transactions out of the clearing arrangement of financial integration. Another is to channel such free market transactions through the clearing arrangement and realize them in the currencies agreed upon by the transactions. Thus in order to facilitate the settlement of multi-lateral payments when some of the members have MERS, all member countries should respect and reinforce the exchange regulations of all members in their states.

Implementation of MERS within AAE-SAP

57. In the context of AAE-SAP, the implementation of MERS requires the clear articulation of its objectives, the conditions for its effective use and practical implementation modalities.

(a) Objectives to be realized

58. The recovery and development objectives of AAF-SAP which can be pursued with MFRS include regional food self-sufficiency; poverty alleviation through the promotion of agriculture, rural development and the satisfaction of critical needs like hunger; encouragement of capital inflows and restriction of outflows; achievement of self-sustained development through sectoral expansion, diversification of the production base, increased manufacturing and higher capacity utilization through essential imports; and improvement in the balance of payments.

(b) Conditions for effective use of MFRS in AAF-SAP

59. The basic conditions for the effective use of MFRS are the complete separability of markets through the elimination of fraudulent transactions across exchange markets due to the existence of a foreign exchange discount between the markets and the application of single multiple rates. The use of MFRS with or without foreign exchange allocation, depending on its relative supply or the state of external reserves, also requires effective administration, control and enforcement to avoid foreign exchange speculation and corruption. There is also need to design relevant complementary policies such as differential interest rates and non-expansionary fiscal and monetary policy as well as trade integration that requires barriers to trade flows. The monitoring of the implementation of MFRS is also important.

Modalities for Implementation of MFS

1. Administrative and institutional arrangements - These should consist of two main parts:

60. (a) Responsibility for implementation - This should be vested in the Central Bank with the effective participation of the allied Ministries of Finance, Planning and Trade. Their specific responsibilities for the design, implementation and enforcement of the rules and controls of MFRS should be defined as clearly as possible at the highest possible level of executive authority;

61. (b) Monitoring Committee - This should be at the highest possible level and consist of officials of the Central Bank as well as the Ministries of Finance, Planning and Trade. Its functions should be the systematic monitoring of the actual implementation of MFRS, so it should ensure the complete separation of foreign exchange transactions or markets in order to eliminate fraudulent transactions and corruption; enforcement of the discipline and controls of MFRS through the imposition of binding sanctions against violations of the regulations of MFRS in order to prevent official abuse; ensure the prompt correction of errors of design and implementation; and respond to unforeseen developments during the application of the multiple rates.

2. Combination of managed crawling peg rates with free rates - the crawl or band for the fixed rates is to avoid

strengthening the budget - the free exchange rates should adjust to independent forces that influence the balance of payments. The parallel rates should not apply to the capital account of the balance of payments. Trade exchange restrictions should be designed to gain as much stability as possible - this requires exempting MFRS with other measures to stabilize the economy;

3. In moving from one exchange rate for all transactions to MFRS with low rates for essential imports and higher rates for other transactions, transfer these other transactions (non-essential imports and capital inflows) to the new rates gradually;

4. Organize the free exchange rates through banks or exchange bureau in order to achieve their stability;

5. Integrate multiple rates with fiscal, monetary and price policies in a non-inflationary direction;

6. The MFRS should be taken as a serious policy that requires a high level of administrative capability and discipline so that its controls can be maintained effectively;

7. Complementary measures are required in order to achieve the objectives of MFRS, e.g., low rate of inflation, attractive interest rates, confidence in the domestic economy, increased capital inflow and foreign investment through economic stability;

8. Other reforms are essential, for example, of the production structure, food supply, changes in consumption habits and higher price elasticity of demand for imports, all implying that MFRS should effectively reduce the demand for money. Thus fiscal policy through well-studied and designed system of taxes and subsidies can reduce the demand for money and change consumption habits;

9. Monetary measures such as selective credit policy, Differential Interest Rate Policy (DIRP) and the reduction of bank lending reserves in ratio towards production for development, reduce inflation and encourage the inflow of remittances;

10. All policy actions should act on both the supply and demand sides of the economy. Thus general export promotion may reduce supplies for domestic consumption unless it is done selectively with measures to increase production and allocative efficiency. This supply-side emphasis is critical because it is the orientation of SAP-SAF.

11. Apply related or complementary policies such as advance import deposit, payment conditions, export and import tariffs, subsidies and rebates that do not conflict with

MFRS. These are alternatives to additional multiple exchange rates.

V. Policy Trade-offs and Complements to MFRS

62. (a) Policy trade-offs with MFRS - As the use of MFRS involves a selective choice of development options, some other policies are trade-offs that tend to neutralize MFRS and they should be avoided. These are:

(i) credit expansion - this is inflationary and weakens the effectiveness of MFRS;

(ii) off-setting trade policies like tariffs, subsidies and rebates on exports and imports should be synchronized with MFRS. For example, if a foreign transaction enjoys the lower of two multiple rates, this amounts to a subsidy on such a transaction and so the imposition of a tax or tariff on it will off-set the incentive given by the multiple rate;

(iii) sales taxes and domestic subsidies on imported goods subject to multiple rates can also cancel out the effects of the MFRS. In all these cases, the differences between real and nominal effective exchange rates should be evaluated to avoid policy conflict.

63. (b) Policies Closely Related to MFRS

(1) Advance import deposit - This policy is the same as exchange spread if the import deposit is large and sustained. It is a form of MFRS or a monetary policy for increasing or contracting the monetary base for credit creation. The effect is once and for all unless the policy is changed. In latin America, its objective has been to reduce the level, or change the structure, of imports so that it is an alternative to devaluation or direct MFRS. Its shortcomings are that it constitutes a free loan by importers to financial institutions and it is inappropriate for capital and invisible transactions such as insurance, travel, etc.

(2) Payment Conditions - this policy package imposes restrictive conditions on international payments. The conditions are designed for restricting some imports, rationing foreign exchange and giving payment priority to essential imports such as machinery, plant and equipment, raw materials and spare parts. they are commonly used for barter or bilateral trade agreements and for partial or full devaluation. Common examples of payments conditions are delayed foreign exchange cover for some imports such as 180 - day grace before payment; five to eight year credit for 80 per cent of the value of imported capital goods like machinery; and advance payment by foreigners for exports of strategic products like uranium. These payment conditions and advance import deposit are temporary measures.

(c) Complementary policies to MERS

64. As exchange rate policy, foreign exchange and the external sector tend to be exaggerated in African countries, these countries have to decide which policies to stabilize and which to adjust. Hence AAF-SAP identifies specific policies that should be used to complement MERs. These are trade policies, differential interest rate policy (DIRP) and fiscal reform.

(1) Trade policies

(i) These involve the selective use of trade measures, including the banning of specified luxury imports, high tax rates on conspicuous consumption and on import of competitive inputs with domestic substitutes;

(ii) Specific export incentives such as tax rebates for processed exports and carefully selected primary export commodities;

(iii) Differential export subsidies, removal of trade barriers and encouraging barter trade to boost intra-African trade;

(iv) Bilateral and multilateral trade agreements on primary commodities.

(v) Advance import deposit and payment conditions as de facto alternatives to additional multiple rates.

(2) Differential interest rate policy (DIRP)

65. This involves :

(i) Sectoral allocation of credit with credit guidelines that favour the food sub-sector and the manufacture of essential products;

(ii) Use of selective nominal interest rates such that the interest rates on loans for speculative activities are higher than the rates on loans and advances for productive purposes, with the resulting weighted real interest rates for savings being positive;

(iii) Creation of a special fund for loans at subsidized interest rates to special economic groups.

66. (3) Fiscal - Monetary Reform - the fiscal and monetary reforms to supplement the MERS should include the devotion of at least 20-25 per cent of total public investment from foreign exchange earnings or foreign loans to agriculture. Other fiscal

---

[1] See AAF-SAP, pp. 39-42.

reforms include the limitation of foreign debt service ratios to levels consistent with accelerating and sustainable development; enlarging the tax base and improving the efficiency and probity of tax collection; removal of subventions to parastatals except those in the social services sector and nationally strategic or basic industries; and use of selective subsidies, pricing policies and related measures to increase the supply of essential commodities for development. The associated monetary reforms involve monetary restraint with low rate of inflation and moderate interest rates through limited, realistic and decreasing rate of deficit financing for productive and nfrastructural investments with low import content as well as the strengthening of intra-African monetary and financial co-operation with payments and clearing arrangements.

VI. Recommendations and Follow-up Action

Recommendations

67. On the basis of the above discussions, the following recommendations on MERS are pertinent for the successful operation of multiple rates in African countries in order to facilitate their accelerated recovery and transformation within the context of AAF-SAP:

1. Feasibility of MERS - African countries should apply an active exchange rate policy that involves the use of multiple rates or multiple currency practices within AAF-SAP for recovery and transformation. Such MERS should be supported by related policies like advance import deposit, payment conditions, differential interest rates, import-export taxes and subsidies where necessary.

2. Objectives of MERS - The basic objectives for using the MERS in African countries should be the acceleration of recovery and transformation through selective promotion of exports; diversification of production in favour of industrialization and the achievement of regional food self-sufficiency; the amelioration of the unbearable burden of external debt service; and the achievement of balance of payments viability.

3. Policy preparation - The adoption of MERS should be preceded or associated with basic economic reforms to create an enabling environment for it. Financial reform to eliminate large deficit financing and high inflation along with changes in import-biased consumption habits are critical here. Fiscal, monetary and price policies should move in the same direction and complement themselves.

4. Duration of MERS - As a recovery and development policy, the duration of the multiple currency practice will vary from country to country. Hence its duration in each country should be a function of the achievement of its objectives.

5. Modality and structure - In order to minimize the administrative demands of the MERS, it should be as simple in design as possible. It should consist of a managed crawling fixed rate or rates that can be adjusted within a band for essential imports, and free rates determined by market forces through the banks or exchange bureau for other imports.

6. Treatment of parallel foreign exchange market - Where an illegal or parallel exchange market exists, the MERS should not aim at eliminating it because this may be chasing a mirage. But the free legal rates of the multiple exchange system should be as close to the parallel rate as possible. This will reduce the premium in the parallel market. This requires that exporters should surrender their export earnings to the banking system so as not to use them to finance the parallel market.

7. Implementation machinery - The multiple rate system should be operated primarily by the Central Bank. The guidelines and regulations for it should be worked out jointly with the Ministries of Finance, Planning and Trade. There should be a clear division of responsibilities among these agencies in the operation of the system in order to ensure that controls and discipline are enforced effectively. So the Central Bank should be given full powers to impose sanctions against any violation of the regulations.

8. Monitoring committee - There should be a Monitoring Committee for MERS to be composed of officials of the Central Bank, Finance, Planning and Trade Ministries. Its functions should be as indicated above.

9. Related policies to MERS -

(a) Policies that are trade-offs against MERS and conflict with it such as neutralising taxes and subsidies on exports and imports should be avoided;

(b) Complementary policies such as domestic taxes and subsidies, foreign exchange allocation to markets, fiscal and monetary restraint, differential interest rates as well as the inducement of capital inflow will facilitate the effectiveness of multiple rates. Some of them are like de facto MERS (e.g. export and import taxes and subsidies), while some like the reform of taxes and expenditure should precede MERS, and others like the restructuring of consumption and production should accompany it.

Follow-up Action for Implementation of MERS in Member States

68. This report provides general technical information on MERS as an AAF-SAP policy instrument. It has established a case for the use of multiple rates as part of a package of policies for accelerated recovery and transformation in Africa. The required follow-up action for its implementation in individual countries should involve three sequences.

69. (a) Detailed Country Feasibility Studies - It is now necessary to move from the general to the specific by undertaking detailed study of the practical use of MERS in individual African countries. The detailed studies should be designed with a format that elicits the most critical information as suggested below, and such studies can be done by member states themselves or with the assistance of the ECA. The detailed study should focus on:

(i) Review of existing and past exchange rate policies, especially in the 1980s;

(ii) Financial history and profile of the country in the past decade;

(iii) Role of exchange rate policy in the country's overall adjustment programme so far;

(iv) The main objectives as well as possible costs and benefits of MERS in the country;

(v) The specific administrative and institutional machinery needed for the implementation of the policy;

(vi) The feasible multiple foreign exchange markets that can be separated and the possible levels of the exchange rates;

(vii) Related policies to MERS to be avoided as trade-offs and those to be used as complementary policies as discussed above;

(viii) Other matters relevant to MERS that are indicative of the special circumstances of the country, e.g., the possibility of relaxing currency zone membership in order to operate MERS.

70. (b) Collation of the detailed feasibility studies by the ECA. This provides more detailed lessons of experience and case-studies, offers opportunities to fill in gaps and modify options that may be proposed in the studies.

REFERENCES

(1) R.A. Mundell (1969) International Economics (London, Macmillan)

(2) R. Dornbush (1986) " Special Exchange Rates for Capital Account Transactions", World Bank Economic Review, 1,1, pp.3-33

(3) J. Frenkel (1978) "International Reserves, Pegged Exchange Rates and Managed Float" in K. Brunner & A. Meltzer eds. Economic Policies in Open Economies, Amsterdam, pp.111-140

(4) M. Bruno (1976) "The Two-Sector Open Economy and the Real Exchange Rate", American Economic Review, vol.66, pp.566-577

(5) M. Bahmani-Oskooee & F. Niroomand (1988) " On the Exchange Rate Elasticity of the Demand for International Reserves - Some Evidence from Industrial Countries", Weltwirtshaftliches Archive, vol. 124, pp. 161-8.

(6) J.S. Lizondo (1987) "Exchange Rate Differential and Balance of Payments under Dual Exchange Markets", Journal of Development Economics (Amsterdam), pp.37-53.

(7) B. Pinto & S. Van Wijnbergen (1986) "Exchange Rate Regimes in Africa" mimeo., World Bank.

(8) M. Obstfeld (1986) " Capital Controls, The Dual Exchange Rate and Devaluation ", Journal of International Economics, (Amsterdam), Vol.20, February, pp.1-20.

(9) A. Lanyi (1975) "Separate Exchange Markets for Capital and Current Transactions", IMF Staff Papers, (Washington), Vol. 22, pp.714-49.

(10) C. Adams & J. Greenwood (1985) "Dual Exchange Rate Systems and Capital Controls : An investigation", Journal of International Economics, Vol.18, pp.43-63.

(11) Bade Onimode ed. (1989) The IMF, World Bank and the African Debt: vol I, The Economic Impact; Vol.II, The Socio-Political Impact (London; Zed)

(12) J.S. Bhandari & C.A. Vegh (1989) " Dual Exchange Markets Under Incomplete Separation - An optimising Model" mimeo, IMF, March 1.

(13) B. Pinto (1987) " Exchange Rate Unification and Budgetary Policy in Sub-Saharan Africa", mimeo. IMF.

(14) G.Johnson et Al (1985) "Formulation of Exchange Rate Policies in Adjustment Programmes", mimeo. IMF, August.

(15) L. Taylor (1988) Varieties of Stabilization Experience Towards Sensible Macroeconomics in the Third World (London, Clarendon, Press).

(16) Consultancy Reports by J. Marshall, M. Kifle and P.Salin for the ECA on MERS and DIRP, 1989.